MULTISTATE TAX COMMISSION

Working together since 1967 to preserve federalism and tax fairness

To: Commission
From: Joe Huddleston
Date: July 21, 2011
Subject: 2011 Annual Report of the Executive Director

This report is a summary of the Commission's organizational and staff activities for the period July 1, 2010 through June 30, 2011.

I. Membership

South Carolina became a sovereignty member on July 1, 2011.

II. Programs & Activities

A. Joint Audit Program

South Carolina joined the Joint Audit Program for both income & franchise and sales & use taxes.

The audit division completed 6 income tax audit and parts of 4 other income tax audits for fiscal year 2011. The audit division also completed 5 sales tax audits and parts of 5 other sales tax audits for fiscal year 2011. There are currently 20 income and 28 sales tax audits in progress. Proposed assessments for fiscal year 2011 from these audits total $96,104,743.

The following chart summarizes hourly data for completed audits for the period July 1, 2010 through June 30, 2011:

	Income & Franchise	Sales & Use	Total
Total Audits	6	5	11
Total States Audited	309	65	374
Total Hours	25,649	7200	32,849
Average Hours per State	83	110	88

Aside from the meetings of the Audit Committee, states in numerous audits have met with staff via teleconferences to discuss particular audits in progress and issues specific to those audits.

Audit division staff provided instruction at two income tax training classes, one statistical sampling class, and one computer assisted auditing class for fiscal year end June 30, 2011.

B. National Nexus Program

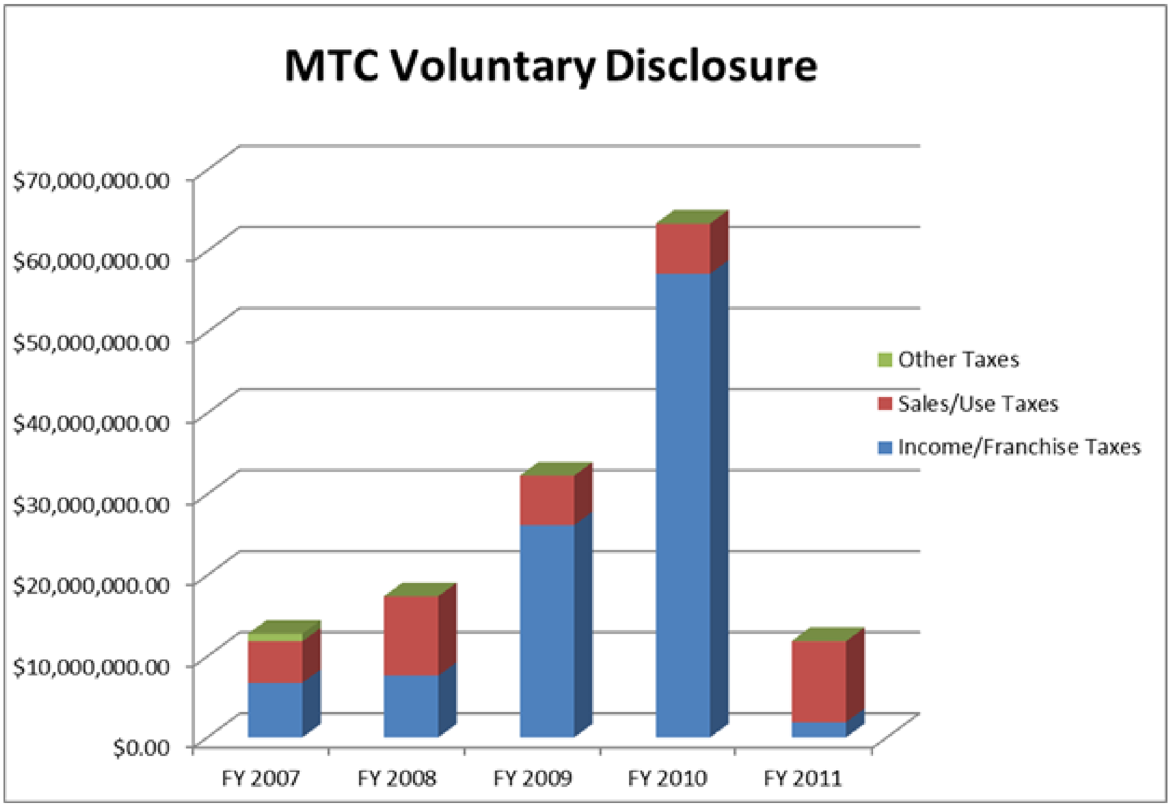
The National Nexus Program opened 95 new voluntary disclosure files and executed 450 individual contracts this fiscal year. The average contract value this fiscal year is $33,300. $11,884,800 has been collected for the states during this fiscal year.[1]

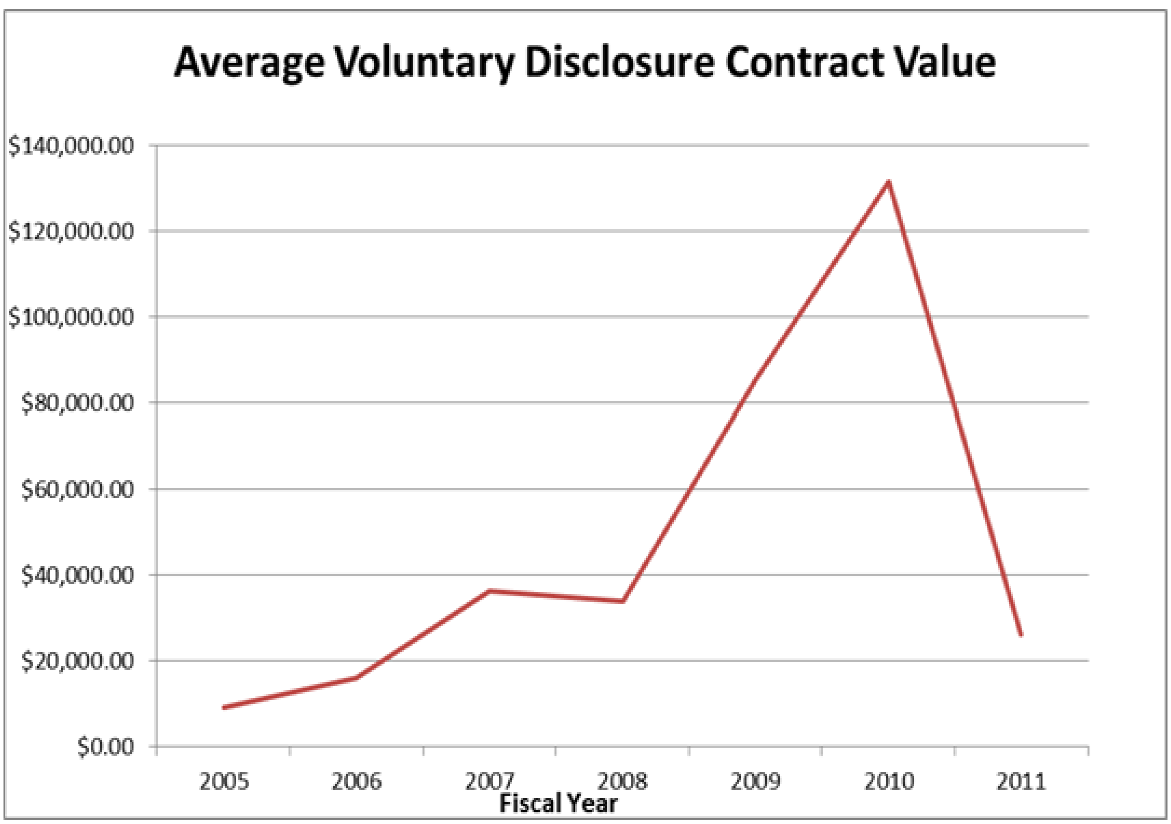
The amount of revenue generated through the program in FY2011 is markedly similar to that of FY2008, which was substantially lower than the intervening two fiscal years. The amount of revenue in FY2009 and FY2010 was unusually large primarily because of a single taxpayer. Such large taxpayers come along unpredictably and cause large spikes in revenue. Comparing FY2011 revenue to most previous years, however, reveals a very productive program.

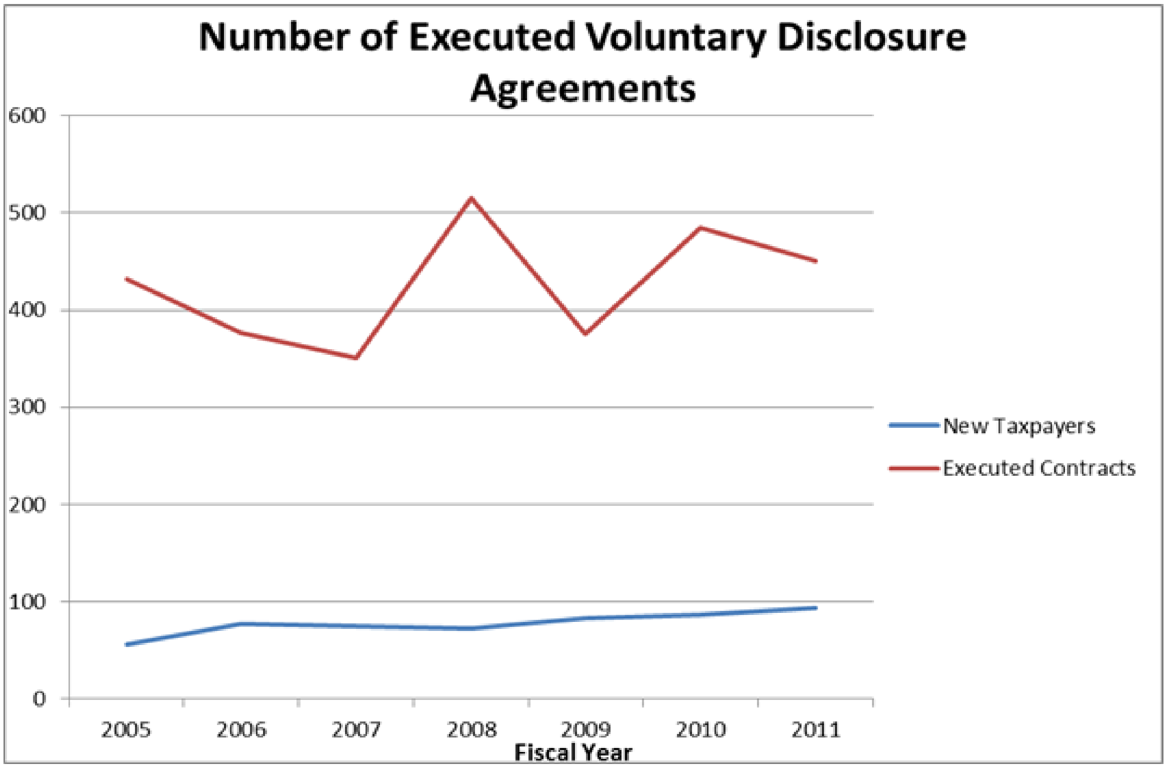
Something interesting to note about FY2011 is that collections from sales & use tax predominate, in contrast to prior years when there was either a rough parity or income tax predominated due to the single large taxpayer. The graphs below present this information graphically.

[chart appears on next page]

[1] The collection amount includes only back tax actually collected (cash basis). It may also contain a trivial amount of penalty, interest, and miscellaneous fees if they were collected before conclusion of the voluntary disclosure. It does not include any tax, interest, penalty, or other thing of value collected after the voluntary disclosure process ended. States almost always collect substantial interest on back tax amounts after the end of the voluntary disclosure process, but the Commission does not include these amounts in its reports.


MTC Voluntary Disclosure
$70,000,000.00
$60,000,000.00
$50,000,000.00
$40,000,000.00
$30,000,000.00
$20,000,000.00
$10,000,000.00
$0.00
FY 2007
FY 2008
FY 2009
FY 2010
FY 2011
Other Taxes
Sales/Use Taxes
Income/Franchise Taxes


Average Voluntary Disclosure Contract Value
$140,000.00
$120,000.00
$100,000.00
$80,000.00
$60,000.00
$40,000.00
$20,000.00
$0.00
2005
2006
2007
2008
2009
2010
2011
Fiscal Year



The Nexus Program responded to frequent requests from tax practitioners, taxpayers, and occasionally states, regarding nexus. This information is provided by telephone.

Nexus Program staff provided instruction at two nexus schools during this period. Staff had updated a portion of the material in advance of each school and will continue to update it into the future to ensure accurate and complete information for students.

C. Legal

The legal division staffs two standing committees: Uniformity and Litigation. The division also holds regular state tax attorney teleconferences; files amicus briefs in state and federal courts; participates as speakers at conferences, symposiums and institutes; and teaches MTC training courses. The legal division provides individual state support by assisting in state litigation and reviewing states' draft statutes, regulations, and legal briefs. The division also provides legal support for the Commission's audit division, training division, and general administration.

Uniformity Work

The legal division staffed ten uniformity projects during this period:

- *Amendments to MTC Model Financial Institutions Apportionment* (under development by a Uniformity Subcommittee Work Group)

- *Amendments to UDITPA and Compact Art. IV related provisions* (under development at Uniformity Subcommittee)
  - Definition of "sales" (Compact Art.IV(1)(g))
  - Sales factor sourcing (Compact Art.IV.17)
  - Factor weighting (Compact Art.IV.9)

- *Model Statutes for Telecommunications Transaction Tax Centralized Administration* (under development at Uniformity Committee)

- *Model Statutes for Associate Nexus Presumption (NY-style "Amazon" Law)* (under development at Uniformity Committee)

- *Partnership or Pass-Through Entity Income Ultimately Realized by an Entity That Is Not Subject to Income Tax* (pending executive committee action on hearing officer's report and recommendations)

- *Amendments to Model Combined Reporting Statute Water's-Edge Tax Haven Provision* (passed bylaw 7 survey and pending commission approval)

- *Model Mobile Workforce Withholding and Individual Income Tax Statute* (passed bylaw 7 survey and pending commission approval)

- *Model Add-back Statute to Address Captive REITs* (passed bylaw 7 survey and pending commission approval)

- *Model Sales & Use Tax Notice and Reporting Statute* (pending executive committee consideration after failure to pass bylaw 7 survey)

- *Model Statute on the Tax Collection Procedures for Accommodations Intermediaries* (Executive Committee referred back to Uniformity Committee after failure to pass bylaw 7 survey)

Litigation Committee Work

The legal division supported the Litigation Committee by organizing and making presentations for the July 2010 and March 2011 in-person meetings. In addition, the legal division organized six state tax attorney teleconferences. All meetings were well attended. Attendance for teleconference meetings generally included representatives from approximately 40 states.

Legal Assistance to States

The legal division consulted with individual states regarding significant on-going litigation strategy and briefs, draft legislation, and draft regulations. We participated in various moot courts. The following *amicus curiae* briefs are in drafting or have been filed this fiscal year:

- *CSX Transportation, Inc.* v. *Alabama Department of Revenue*, USSC No. 09-520 131 S.Ct. 1101 (2011) (Remanded)

- *Equifax, Inc. and Equifax Credit Information Services, Inc. v. Mississippi State Tax Commission*, Mississippi Supreme Court No. 2010-TS-01857 (Filed June 16, 2011; decision pending)

- *The Gillette Company et al. v. California Franchise Tax Board*, (appeal filed December 2, 2010, 1st App. Dist., Div. 4, Case No. A130803; amicus brief to be filed November 5, 2011)

Commission Support

During this fiscal year, the legal division provided support for the Commission's general administration by addressing open meetings issues, records requests, researching and making recommendations for record retention policies, and filing corporate registrations and reports. The division provided legal assistance to the Commission's audit division on a number of challenging audit related procedural and substantive issues. legal division (along with National Nexus Program staff) taught MTC nexus training in Helena, Montana, and Denver, Colorado. Division staff also taught Corporate Income Tax and Combined Reporting Training in Columbus, South Carolina; Birmingham, Alabama; and Boston, Massachusetts. The division monitored and reported on the activities of the Streamlined Sales and Use Tax Governing Board and its Committees. In addition, the division assisted in communicating the Commission's position on bills before Congress, including BATSA, Digital Goods, VoIP, Mobile Workforce, Streamlined Sales Tax, and others.

D. Policy Research

MTC Project on Revising Model Statute on Apportioning Income of Financial Institutions — The policy research director continues to work with other MTC staff, state revenue agency personnel, and industry representatives to develop model apportionment statute, and otherwise provide support for this project.

Administration of Telecommunications Transaction Taxes — The policy research director is assisting the Sales & Use Tax Subcommittee of the Uniformity Committee with their project of developing models of centralizing administration of local telecommunications transactions taxes.

Support for MTC federal legislative response efforts — The policy research director has worked with other MTC staff and Patuxent Consulting in preparing responses to federal legislation with state business tax implications.

Multistate Tax Commission Review —

- Production of winter 2011 issue of the *Review*.
- Wrote article on State Corporate Tax Bases during the Recession.
- Edited article by Ken Beier on FCC National Broadband Plan.
- Edited a response by Joe Huddleston to OECD on taxation of intangible capital.
- Production of spring 2011 issue of the *Review* in progress.
- Wrote article on State Corporate Tax Bases during the Recession.
- Edited article by Professor Tracy Gordon on State and Local Government Finances.
- Wrote companion article to Prof. Gordon's article.
- Edited a letter by Joe Huddleston to Secretary of the Treasury Timothy Geithner on Corporate Tax Reform in a Time of Fiscal Crisis.

Other Activities —

- Organized session at FTA Revenue Estimating Conference in Sun Valley, Idaho on incidence of state and local taxes initially imposed on business, September 2010.
- Working with Census Bureau personnel (Governments Division) on improving quarterly estimates of state/local taxes; and, revising definitions of state/local taxes initially imposed on businesses and contents of 2012 Census of Governments; discussed a paper by Brian Zamperini and Marcus Graham at a session organized by Governments Division at annual National Tax Association meeting in November 2010.
- Organized meeting of Tax Economists Forum on State Fiscal Conditions December, 2010.
- Organized second meeting of Tax Economists Forum on State Fiscal Conditions February, 2011.
- Organized meeting of Tax Economists Forum, June 1, 2011
- Nominated to Advisory Board of National Tax Association
- Monitor state adoption of MTC model statutes, regulations, and guidelines.

E. Training

The Training staff supported the following training activities since July 1, 2010:

- *Corporate Income Tax Course*

  October 12-13, 2010, in Columbia, South Carolina, for 24 students from the South Carolina Department of Revenue.
  March 14-16, 2011, in Boston, Massachusetts, for 102 students—95 from the Massachusetts Department of Revenue and 7 additional students from Idaho, Indiana, and Vermont.

- *Nexus School*

  October 26-27, 2010, in Helena, Montana, for 27 students from Alaska, Montana, South Carolina, and Wisconsin.

  May 11-12, 2011, in Denver, Colorado, for 52 students—35 from Colorado and 17 additional students from Alaska, Idaho, Louisiana, Minnesota, North Dakota, Washington, and West Virginia.

- *Statistical Sampling for Sales and Use Tax Audits*

  March 28-31, 2011, in Chicago, Illinois, for 8 students—7 from the private sector and 1 student from North Dakota.

- *Computer Assisted Audit Training Using Excel*

  May 17-18, 2011 in Cheyenne, Wyoming, for 21 students—16 from the Wyoming Department of Audit and 5 from Colorado.

In addition, the following training events were held for state and MTC staff:

- *Federal Schedule UTP (Uncertain Tax Position Statement)*
  March 3, 2011 in Kansas City, Missouri (in conjunction with MTC committee meetings), for 40 state participants.

- *Corporate Income Tax Training*
  May 10-12, 2011, in Chicago, Illinois, for MTC income tax audit staff.

Discussions are underway with several states regarding scheduling of courses. This will be affected by the availability of funding and the priorities of new state administrations that take office in January.

The director of training coordinated the July 28 Annual Meeting Conference. He also wrote article on Federal Communications Commission Broadband Plan, Broadband Deployment Encounters State and Local Taxation, for the winter 2011 issue of the MTC *Review*.

We have renewed our certification with the National Association of State Boards of Accountancy (NASBA) as a CPE sponsor.

III. Correspondence

I sent several letters to Congress this past year regarding preemptive federal legislative proposals and also letters to the United States Secretary of the Treasury and to the OECD. The following summarizes this correspondence:

- Letter responding to the Organization for Economic Cooperation and Development's request for comments from interested parties on its new project regarding transfer pricing aspects of intangible assets, September 2, 2010.

- Letter to Subcommittee on Courts, Commercial and Administrative Law & Chairman, Committee on the Judiciary, RE: *Business Activity Tax Simplification Act*, H.R. 1083, October 11, 2010 (I also distributed an analogous form letter for use by the states).

- Letter to United States Secretary of the Treasury & Chairman, House Ways and Means Committee urging them to seek input from representatives of state and local governments when undertaking federal tax reform efforts, January 31, 2011.

- Letter to Committee on Transportation & Infrastructure, RE: Graves/Cohen Request for Amendment to FAA Reauthorization Bill Regarding Rental Cars, March 7, 2011.

- Letter to Subcommittee on Courts, Commercial and Administrative Law, RE: H.R. 1439, *Business Activity Tax Simplification Act of 2011*, April 11, 2011.

- Letter to Subcommittee on Courts, Commercial and Administrative Law, RE: H.R. 1439, *Business Activity Tax Simplification Act of 2011*, May 2, 2011.

- Letter to Subcommittee on Courts, Commercial and Administrative Law, RE: H.R. 1860, *Digital Goods and Services Tax Fairness Act of 2011*, June 2, 2011.

- Letter to Subcommittee on Courts, Commercial and Administrative Law, RE: H.R. 1864, *Mobile Workforce State Income Tax Simplification Act of 2011*, June 7, 2011.

IV. Administration

Shan Chen, policy research intern, has accepted a full time position with the International Monetary Fund as of November 15, 2010.

TaxNet Governmental Communications Corporation (TGCC), was a joint effort of the MTC and FTA. Last year, the TGCC board approved distribution of the funds currently residing in the TGCC bank account equally between FTA and MTC, with each organization remaining subject to any restrictions on the subsequent spending of those funds based upon the TGCC bylaws. They also approved dissolution of TGCC upon distribution of the funds and payment of any fees or costs involved. The Executive Committee reviewed the actions of TGCC and consented to the approved course of action at its meeting in December 2010.

André Barbé, Ph.D candidate in economics, Rice University; and Yi Feng, accounting major, University of Iowa, began working as policy research interns in June.

V. Presentations

The following are the programs, conferences, and other events of outside organizations at which members of the staff represented the Commission during the reporting period:

<u>JULY</u>

- BNA Webinar, Sales and Use Tax Notice and Reporting Requirements (Sicilian)
- Southeastern Association of Tax Administrators, Little Rock, Arkansas (Huddleston)

<u>SEPTEMBER</u>

- North Eastern States Tax Officials Association; Boston, Massachusetts (Matson, Sicilian)
- KPMG Payroll Forum; Chicago, Illinois (Sicilian)

<u>OCTOBER</u>

- COST Annual Meeting, Phoenix, Arizona (Huddleston)
- AICPA Tax Division State & Local Taxation Technical Resource Panel; Washington, D.C. (Matson, Sicilian)
- Chicago Tax Club; Rosemont, Illinois (Huddleston)

<u>NOVEMBER</u>

- Georgetown University Law Center SALT Certificate Program Meeting; Washington, D.C. (Huddleston)
- California Tax Policy Institute; San Diego, California (Huddleston, Sicilian)
- Hartman State and Local Tax Forum; Nashville, Tennessee (Fort)
- Michigan Tax Conference; Detroit, Michigan (Sicilian)

- Institute for Professionals in Taxation; Miami, Florida (Shimkin)
- New Jersey Society of Certified Public Accountants; Roseland, New Jersey (Shimkin)
- NCSL Task Force Meeting; Scottsdale, Arizona (Huddleston)
- NTA Annual Conference on Taxation; Chicago, Illinois (Dubin)

DECEMBER

- Graduate Accounting Program Guest Lecturer, American University, Washington, D.C. (Huddleston)
- New York University State & Local Tax Institute, New York, New York (Huddleston, Fort)

JANUARY

- Cornell State & Local Tax Group Luncheon, New York, New York (Shimkin)
- 20th Annual Ohio Tax Conference Columbus, Ohio (Huddleston)

FEBRUARY

- Deloitte and Florida Bar Tax Section's National Multistate Tax Symposium, Orlando, Florida (Huddleston, Matson)
- New York University State & Local Tax Group Luncheon, New York, New York (Huddleston)
- FTA-MTC New Commissioners Seminar, Dallas, Texas (Huddleston, Matson, Sicilian)

MARCH

- ABA/IPT Sales and Use Tax Conference, New Orleans, Louisiana (Huddleston, Sicilian)

APRIL

- Morrison & Foerster's State & Local Roundtable Lunch Session, New York, New York (Huddleston)
- Deloitte Multistate Tax Summit, Chicago, Illinois (Koenig)
- Ernst & Young's 6th Annual Domestic Tax Conference, New York, New York (Huddleston)

MAY

- Michigan Tax Conference, Plymouth, Michigan (Fort)
- Georgetown State and Local Tax Conference, Washington, D.C. (Fort)
- COST Annual Spring Audit Meeting, Bernalillo, New Mexico (Fort)
- 10th Annual North Carolina/South Carolina Tax Section Workshops, Kiawah Island, South Carolina (Huddleston)

JUNE

- BNA State Tax Roundtable, Washington, D.C. (Shimkin)
- IPT Corporate Income Tax Advanced Training, Fairfax, Virginia (Sicilian)
- Federation of Tax Administrators Annual Meeting, Omaha, Nebraska (Huddleston, Sicilian)
- BNA Web-based Seminar, *Got Nexus? Analyzing BNA's 2011 Survey of State Tax Departments*, Washington, D.C. (Shimkin)
- Annual Multistate Tax Institute, Milwaukee, Wisconsin (Huddleston)
- IPT 35th Annual Conference, San Antonio, Texas (Sicilian)